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# Notes on the Revenue Act of 1934

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## Significant Changes in the Income Tax Law

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(*New York Office*)

The primary purpose of the Revenue Act of 1934 was originally stated to be the prevention of tax avoidance. The final result was the most drastic revision of our revenue system in recent years. In the effort to eliminate tax avoidance Congress has made many distinct improvements in the law, but has also created serious inequities, such as the abolition of consolidated returns, and the disallowance of net capital losses as a deduction from income though continuing the tax on net capital gains. The purpose of this article is to summarize the principal new provisions in the income tax section of the new Revenue Act.

### Application of New Law

The new law applies only to taxable years beginning after December 31, 1933. It does not apply to fiscal years beginning in 1933 and ending in 1934, but applies to the calendar year 1934 and to fiscal years beginning in 1934. Prior revenue acts became effective on January 1, and in the case of fiscal years it was necessary to compute the tax under two different laws. This is no longer necessary; the change in policy was in the interest of simplification.

### Capital Gains and Losses

*Individuals:* An entirely new treatment of capital gains and losses is adopted in the new law. The flat rate of 12½ per cent. on capital gains and the flat limitation of 12½ per cent. on capital losses have been discontinued. In the case of individuals a net capital gain is subject to the regular normal and surtax rates but, if the asset has been held more than one year, only a portion of the gain must be included in taxable income, such portion depending upon how long the asset has been held. Similarly, if the asset has been held more than one year, only a portion of the loss is deductible, but a net capital loss may be deducted from ordinary income only to the extent of $2,000.

A capital asset is any asset other than stock in trade or other property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business. Capital assets are not limited to securities. Many questions will arise as to when property is held primarily for sale to *customers*, particularly in the case of security traders. It has not yet been finally determined by the courts whether a trader who sells securities through a broker is selling to *customers;* the Treasury will probably hold that he is not.

The portion of the capital gain or loss to be taken into account in computing net income is as follows:

*Capital Asset Held*

| | |
|---|---|
| One year or less | 100 per cent. |
| 1–2 years | 80 Do |
| 2–5 Do | 60 Do |
| 5–10 Do | 40 Do |
| More than 10 years | 30 Do |

In determining the period for which an asset has been held, if the property takes the tax basis of other property (as in a tax-free exchange) or the tax basis of another person (as in the case of gifts) the period the original property was held or the period the property was held by the donor or transferor must be added.

The law provides that gains or losses from short sales shall be considered as gains or losses from sales or exchange of capital assets. The report of the Senate Finance Committee indicates that this section was intended to cover cases where a person owns a security, makes a short sale, and later closes the transaction by delivery of his own security. In the ordinary short sale where the taxpayer does not own the security at the time of the sale but later purchases the security and makes immediate delivery to close his transaction, it will probably be held that the property sold has been held less than one year.

The capital gain and loss provisions apply only to gain or loss from the *sale or exchange* of property. They do not apply to property which becomes worthless and is not sold. The law specifically provides that amounts received by the holder upon the retirement of bonds, debentures, notes or other evidences of indebtedness with interest coupons or in registered form, shall be considered as received in exchange therefor, and accordingly, as giving rise to capital gain or loss. Unlike the 1932 law no reference is made to the gain or loss realized by the corporation from the retirement of its own obligations, apparently indicating an intention to treat such gain or loss as ordinary gain or loss rather than capital gain or loss. A gain realized by a stockholder from the retirement of his capital stock is 100 per cent. taxable, but a loss is apparently subject to the graduated scale.

In determining the effect of capital gains or losses upon net income the first step is to segregate the capital gains and losses according to the length of time the assets were held, and to apply to such gains and losses the percentages shown in the aforementioned table. These percentages represent the portion of the capital gain or loss to be taken into account, not the rates of tax. The capital losses (as reduced by the graduated percentages) should then be deducted from the capital gains (as reduced by the graduated percentages). If the net result is a capital gain such gain is 100 per cent. taxable for both normal and surtax purposes. If the net result is a capital loss *such loss is deductible from ordinary income only to the extent of $2,000.* This is one of the most serious inequities in the new law. If net capital losses are not deductible net capital gains should not be taxable, or at least taxpayers should be permitted to carry forward net capital losses to subsequent years.

*Corporations:* The provisions regarding capital gains and losses are the same in the case of corporations as in the case of individuals, except that the graduated percentages of gain or loss to be taken into account do not apply to corporations. *Regardless of how long a capital asset has been held* by a corporation, capital losses are deduct-

ible only to the extent of $2,000 plus the capital gains. The only exception is in the case of a domestic bank or trust company a substantial part of whose business is the receipt of deposits. If such a bank sells a bond, debenture, note or other evidence of indebtedness with interest coupons or in registered form at a loss, such a loss is fully deductible from any income to the extent that the loss does not exceed the difference between the *face* value of the bond and the sale price; that is, if the bond was purchased at a premium and then sold or redeemed the loss is subject to the limitation on capital losses to the extent that it does not exceed the premium. If a bank incurs losses on the sale of stocks as distinguished from bonds the losses are subject to the limitations, unless the bank can show that the stocks were held for sale to customers and therefore were not capital assets.

Plant, machinery and equipment are capital assets. A loss from abandonment or scrapping of such assets, as distinguished from a loss on a sale or exchange is fully deductible. Where such assets are first abandoned and then sold within the year there will undoubtedly be controversies as to whether the loss resulted from abandonment or from sale. Ordinarily in such cases the loss would be incurred and should be recognized from an accounting standpoint before the sale is made. Moreover the law allows a reasonable deduction for exhaustion, wear and tear and obsolescence. When a plant asset is sold at a loss, and the loss does not result from a decline in prices, it may well be argued that the corporation is entitled to deduct the unrecovered part of the basis as additional depreciation or obsolescence, so that the sale would result in neither gain nor loss.

### Consolidated Returns

Consolidated returns are *not* permitted under the new law except in the case of railroad corporations. Since each corporation must file a separate income tax return it will not be possible to offset a loss of one company against a profit of an affiliated company. This is probably the most unfair provision in the statute and corporations should immediately take steps to protect themselves insofar as they may properly do so. A number of things may be done. It may be possible to dissolve some subsidiaries. Intercompany sales prices which may heretofore have been arbitrary may be adjusted to fair market prices. Overhead and administrative charges may be apportioned more scientifically. Interest rates may be adjusted to current conditions. Some corporations may be recapitalized. Securities with unrealized appreciation or depreciation may be transferred. There are countless other proper means by which an affiliated group of corporations may avoid paying taxes on entirely artificial profits.

Arbitrary intercompany adjustments to avoid tax will, of course, not be permitted. The Commissioner has authority under the statute to distribute, apportion or allocate gross income or deductions between organizations or businesses controlled by the same interests whenever necessary to prevent evasion of taxes or clearly to reflect the income of each organization or business.

Particularly in the case of large affiliated groups with complicated intercompany transactions it will be diffi-

cult for both the Treasury and the taxpayers to determine accurately the separate income of each taxpayer, and litigation is bound to result.

Corporations with fiscal years ending late in 1934 will have a distinct advantage as compared with calendar year companies since they will be permitted to file consolidated returns for such fiscal year, which may end as late as November 30, 1934. This will enable them to dissolve subsidiaries tax-free in a consolidated return period if desirable, and also to plan their accounting for the next year on a separate tax return basis. Calendar year companies, or companies with fiscal years ending in the early part of 1934, kept their accounts for several months on the assumption that consolidated returns would be permitted. For this reason there is a movement at this writing to amend the law to permit companies to file a consolidated return for the accounting period first ending after the passage of the Act (which in the case of calendar year companies will be the calendar year 1934) on the ground that prior to the passage of the Act the companies did not know that separate returns would be required and did not keep their accounts with a view to the determination of the separate income of each company. Taxpayers who are affected should actively support this proposed amendment.

The income tax rate on railroad corporations, if they elect to file consolidated returns, is 15¾ per cent.

### Personal Holding Companies

In order further to prevent the avoidance of surtaxes through the organization of personal corporations to hold securities, etc., the new law imposes the following surtaxes on the "undistributed adjusted net income" of personal holding companies:

30 per cent. of the amount not in excess of $100,000

40 per cent. of the amount in excess of $100,000

A personal holding company is defined as any corporation (other than a domestic bank, a substantial part of whose business is the receipt of deposits, and other than a life insurance or surety company) if (A) at least 80 per cent. of its gross income for the taxable year is derived from royalties, dividends, interest, annuities, and (except in the case of regular dealers in stock or securities) gains from the sale of stock or securities, and (B) at any time during the last half of the taxable year more than 50 per cent. in value of its outstanding stock is owned, directly or indirectly, by or for not more than five individuals. Stock owned by a corporation, partnership, estate or trust is considered to be owned by its shareholders, partners or beneficiaries, and the stock owned by members of a family is considered to be owned by one individual. The specified sources of income do not include income from rents; accordingly, the ordinary real estate company is not a personal holding company.

The "undistributed adjusted net income" is arrived at as follows:

| | | |
|---|---|---|
| 1. Start with net income for normal tax, per income tax return ...................... | | $.... |
| 2. *Add:* | | |
| (a) Such income on obligations of the United States or of corporations organized by Congress as is exempt from normal tax only....... | $.... | |
| (b) Dividends received from domestic corporations.. | .... | .... |
| | | $.... |

3. *Deduct:*
   (a) Federal income and excess profits tax other than this surtax......$....
   (b) Charitable and other contributions which would be deductible by individuals.............. ....
   (c) Losses from sales or exchanges of capital assets which are disallowed for income tax purposes............. .... ....

4. Adjusted net income......... $....

5. *Deduct:*
   (a) 20 per cent. of the excess of item (4) over the amount of dividends received from domestic personal holding companies...............$....
   (b) Amounts used or set aside to retire indebtedness incurred prior to January 1, 1934, if such amounts are reasonable with reference to the size and terms of such indebtedness.. ....
   (c) Dividends paid during the taxable year...... .... ....

6. Undistributed adjusted net income...................... $....

If no dividends are received from other personal holding companies the corporation may keep undistributed 20 per cent. of its adjusted net income without incurring liability for surtax. The requirement that the adjusted net income must be reduced by the dividends received from other domestic personal holding companies before computing the 20 per cent. exemption was to prevent avoidance of the tax by the organization of a chain of personal holding companies so that 20 per cent. of the income of the first company might be permitted to remain in each of five successive companies tax free. No credit for foreign income taxes paid is allowed against this personal holding company surtax.

The personal holding company surtax does not apply if all the shareholders include in gross income in their personal income tax returns as dividends their share of the adjusted net income of the corporation for such year, and such shareholders will not again be taxable when such earnings are distributed to them.

Though the law allows the deduction of amounts set aside to meet certain indebtedness it does not allow the deduction of amounts set aside to make up an operating deficit. This omission creates a very unfair situation: a corporation may be prohibited by state law from paying a dividend because of an operating deficit and yet may be subject to this penalty tax of 30 or 40 per cent. for not paying it. To avoid the penalty tax the stockholders may have to include the current earnings in their tax returns as taxable dividends, even though a distribution of such earnings when the corporation had an operating deficit would not be taxable under decisions of the Board of Tax Appeals.

Even if the corporation had a capital surplus and could legally distribute and did distribute the current earnings such a distribution might not be deductible under a literal interpretation of the statute. It is doubtful if this section as drafted expressed the real intention of Congress. The section permits the deduction of "dividends" paid in arriving at undistributed adjusted net income. The word "dividend" is defined in the Act as a distribution out of earnings or profits. Assume that a corporation has a paid-in surplus of $1,000,000, and an

operating deficit of $500,000 at December 31, 1933, and that it earns $100,000 in the year 1934 which it distributes to its stockholders. This distribution would probably not be a dividend within the statutory definition since it is really paid out of capital surplus, but it is inconceivable that Congress intended to apply the 30 or 40 per cent. surtax to a corporation which has paid out every cent that it has earned and more.

The section will undoubtedly result in the dissolution of many personal holding companies, where the companies can be liquidated without the payment of excessive taxes. As previously pointed out, any gain realized by a stockholder from the liquidation of a corporation is 100 per cent. taxable for both normal and surtax purposes, though losses are apparently subject to the graduated scale according to the period the stock has been held. Where the stock has been held for more than one year and a corporation is to be liquidated at a profit it would accordingly be advantageous to sell the stock before liquidation so as to secure the benefit of the graduated percentages of gain to be taken into account.

**Improper Accumulations of Surplus**

Corporations other than personal holding companies are still subject to a penalty tax if formed or availed of for the purpose of preventing the imposition of the surtax upon its shareholders *or the shareholders of any other corporation* through the accumulation of profits. The words in italics were added to reach subsidiary companies. The penalty tax is reduced in the new law from 50 per cent. to the following rates:

25 per cent. of the adjusted net income not in excess of $100,000

35 per cent. of the adjusted net income over $100,000

The adjusted net income subject to this tax is the net income for income tax purposes, including such interest as is only exempt from normal tax, plus dividends received from domestic corporations, but diminished by dividends paid during the taxable year. This latter deduction is new.

The reduced rate of this penalty tax may be expected to result in stricter enforcement of this section.

**Sales to Family or Controlled Corporation**

The new law prohibits the deduction of any loss from the sale or exchange of property, directly or indirectly, (a) between members of a family, or (b) except in the case of distributions in liquidation, between an individual and a corporation in which such individual owns, directly or indirectly, more than 50 per cent. in value of the outstanding stock. An individual is considered to own the stock owned, directly or indirectly, by his family. Any gains from such sales are fully taxable. These restrictions apparently do not apply to sales from one corporation to another corporation, however controlled.

Even though a loss is disallowed under this section the law contains no provision permitting the vendee to take the vendor's tax basis in determining gain or loss on the subsequent sale of the property.

**Depreciation**

The law with respect to depreciation has not been changed but the Secretary of the Treasury has announced his intention to raise 85 million dollars

of additional revenue through a reduction of depreciation allowances. Taxpayers are being requested on short notice to prepare elaborate schedules of depreciable property and depreciation heretofore allowed, and the burden is placed on the taxpayer to prove that the depreciation rates are not excessive.

**Publicity of Returns**

Every person, including a corporation, partnership or trust, must file with his return a statement containing the following information: (1) name and address, (2) total gross income, (3) total deductions, (4) net income, (5) total credits for normal tax, and (6) tax payable. This statement will be open to public inspection in the office of the Collector for three years. If the statement is not filed the Collector is authorized to prepare it from the return and add five dollars to the tax. This comes very close to complete publicity of income tax returns.

Every corporation must include in its return a list of all officers and employees receiving more than $15,000 as compensation and the amount paid to each. The Secretary of the Treasury will submit an annual report to Congress containing the names of and the amounts paid to each such officer and employee and the name of the paying corporation.

**Tax Basis of Property**

In the case of property acquired by gift, the basis for determining gain, depreciation or depletion is the transferor's basis as heretofore. The basis for determining loss, however, is the transferor's basis or the fair market value of the property at the time of the gift, whichever is lower. The purpose of this change was to prevent tax avoidance by transferring losses, for example, from one spouse to another. It is still possible to transfer gains, however.

Under the prior law, in the case of property acquired prior to March 1, 1913 the basis for all purposes was the cost or March 1, 1913 value, whichever was higher. Under the new law if the March 1, 1913 value is greater than cost such value may be used for computing gain, depreciation, or depletion, but cost must be used for determining loss. Under this rule if the selling price is more than cost but less than March 1, 1913 value there will be neither gain nor loss. In comparing the cost with the value at March 1, 1913 adjustment of the cost must of course be made for depreciation, etc. prior to March 1, 1913.

If property is contributed to a partnership by a partner the basis to the partnership under the new law is the same as the basis to the contributing partner.

If property is acquired by bequest, devise, or inheritance or by the decedent's estate from the decedent, the basis under the new law is the fair market value at the time of acquisition, which the United States Supreme Court has interpreted to be the date of death. It is immaterial whether the property is real or personal, or whether it passes by general or specific bequest.

The basis described above for partnership property and property acquired at death will apply to any property sold during the effective period of the 1934 law, regardless of when the property was acquired; it must also be used for computing all depreciation and depletion under the 1934 law.

### Instalment Sales

In the case of a casual sale of personal property, or a sale of real property, in order to report the profit on an instalment basis the initial payments must not exceed 30 per cent. of the selling price, instead of the 40 per cent. provided in the prior law. If the sale was made in a taxable year beginning prior to January 1, 1934, and was accordingly an instalment sale under the law then in effect, the taxpayer may continue to report the income from the sale on the instalment basis. Taxpayers who regularly sell personal property on the instalment plan may report on the instalment basis as heretofore regardless of the percentage of initial payments.

The new law contains a provision to the effect that any gain or loss resulting from the disposition of instalment obligations shall be considered as resulting from the sale or exchange of the property in respect of which the instalment obligation was received, and accordingly the gain or loss would be subject to the graduated percentages, according to the length of time the property was held. Apparently, in determining the applicable percentage of gain or loss to be taken into account the length of time the property itself was held is the controlling factor, regardless of how long the instalment obligations were held. This provision also apparently applies when the instalment obligations are disposed of during the effective period of the 1934 law even though the sale was made under a prior law. It is not entirely clear as to whether the provision in question applies to cases where the obligations are satisfied by the vendee at their face value, though the report of the Senate Finance Committee indicates that it was intended to apply to such cases. Until this point is clarified by regulations, taxpayers might do well to sell the instalment obligations just prior to their payment if it would be advantageous to secure the benefit of the graduated percentages on the gain.

### Reorganizations

The reorganization provisions have been narrowed by excluding from the tax-free transactions the distribution by a corporation, in pursuance of a plan of reorganization, of stock or securities in a corporation a party to the reorganization without the surrender of stock or securities in the distributing corporation. It is doubtful whether this change will accomplish any real purpose. Reorganization plans will be modified to embrace a surrender of securities by shareholders.

The new law commendably clarifies the definition of a reorganization, to make it clear that an acquisition of the stock or assets of one corporation by another corporation is a reorganization whether or not it constitutes a merger or consolidation. This is probably the correct interpretation of existing law, though there have been some decisions to the contrary. Under the new law, however, the acquisition of stock or assets must be solely for voting stock and in the case of the acquisition of the stock of another corporation 80 per cent. of the voting stock and 80 per cent. of all other classes of stock must be acquired, instead of the mere majority required by the prior law.

Adequate provision is made to continue the old tax basis in the case of tax-free exchanges made under the prior law, even though the exchanges would be taxable under the new law.

**Annuities**

Under the prior law amounts received as an annuity under an annuity or endowment contract were not taxable until the taxpayer recovered the total consideration or premiums paid. Under the new law a taxpayer receiving annuity payments must include in his taxable income for each year three per cent. of the aggregate premiums or consideration paid. The balance of the annuity payments received in each year may be excluded from taxable income until when added to the amounts excluded under prior laws they equal the total premiums or consideration paid. The provision prohibiting the deduction of interest in connection with purchasing or carrying an annuity is eliminated.

**Partnerships**

Since under the new law capital losses are allowed as a deduction only to the extent of $2,000 plus the capital gains, it follows that, if a partnership sustains a capital net loss, the individual partners can avail themselves of the net loss only to the extent of $2,000 in total.

**Partnership Fiscal Years**

When a partner reports his income for the calendar year 1934 and is a member of a partnership with a fiscal year ended in 1934, the new law provides that the partnership income for the fiscal year shall be computed under the Revenue Act of 1932, but that the graduated percentages of gain or loss to be taken into account as provided in the new law shall be substituted for the capital gain and loss provisions of the 1932 law. The law provides, however, that the provision in the new law, which limits the deduction of capital losses to the capital gains plus $2,000, shall not apply. The law does not state whether the limitation in Section 23 (r) of the 1932 law on losses upon the sale or exchange of stocks or bonds held less than two years should apply in such a case. It was apparently not intended to apply, since the treatment of losses in Section 23 (r) of the 1932 law can not be reconciled or combined with the graduated percentage method in the new law.

**Statute of Limitations**

Additional taxes may be assessed under the new law within three years after the return was filed or was due, whichever is later. If there is omitted from gross income an amount in excess of 25 per cent. thereof, the tax may be assessed within five years.

Refund claims may be filed within three years from the time the return was filed or within two years from the time the tax was paid.

**Other Matters**

The last return of a decedent must include all accrued income and expenses.

There is a new option in the case of coal, metal and sulphur mines to compute depletion with or without regard to percentage depletion.

Dividends from foreign corporations are fully taxable to corporations and individuals, even though the income of the foreign corporation is all derived from the United States.

Wagering losses are deductible only from wagering gains.

The income of a revocable trust is taxable to the grantor, even though

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# Excise Taxes under the Revenue Act of 1934

By Herman A. Tufel
(*New York Office*)

In addition to the excise taxes imposed by the Revenue Act of 1932, the National Industrial Recovery Act, effective June 16, 1933, approximately one year after the enactment, on June 6, 1932, of the Revenue Act of 1932, imposed a capital stock tax and an excess profits tax upon corporations, a tax of 5 per cent. at the source upon the receipt of dividends and an increase of one-half cent per gallon over the one cent tax upon sales of gasoline provided in the Revenue Act of 1932.

It was the general understanding that these new taxes were to be temporary and that the repeal of the eighteenth amendment would enable the Government to obtain sufficient revenue from a tax upon alcoholic beverages to offset the revenue obtained from these particular taxes. The Committee on Ways and Means of the House of Representatives in its report on the bill said in this respect:

> The . . . additional taxes described . . . are temporary in character and may be eliminated by proclamation by the President when operating revenues exceed operating expenditures or when the repeal of the eighteenth amendment opens a new and ample source of revenue to the Government.

The report upon the bill by the Senate Committee on Finance stated:

> Section 216 provides for the discontinuance of the tax on dividends, the additional one-half cent a gallon on gasoline, and the capital stock and excess-profits taxes in the event that the eighteenth amendment is repealed or the operating receipts of the Government exceed its operating expenditures. The date of the earlier of these events is to be proclaimed by the President. The repeal of the tax on dividends and the additional one-half cent on gasoline is made effective as of January 1 next following the date so proclaimed. No capital stock tax will be imposed subsequent to the date so proclaimed, while the excess-profits tax will not apply in respect of any taxable year beginning after that date.

The National Industrial Recovery Act also extended the various excise taxes imposed by the Revenue Act of 1932 for one year from the dates in 1934 at which they would otherwise have terminated.

The President, on December 5, 1933, proclaimed December 5, 1933 as the date of the repeal of the eighteenth amendment to the Constitution.

## Capital Stock Tax

Section 215 of the National Industrial Recovery Act imposed a tax of $1 for each $1,000 of the adjusted declared value of its capital stock upon every domestic corporation for each year ending June 30, with respect to carrying on or doing business for any part of such year and a like tax upon foreign corporations with respect to carrying on or doing business in the United States, upon the adjusted declared value of capital employed in the transaction of its business in the United States.

The corporations exempted from income tax by Section 103 of the Revenue Act of 1932 and any insurance company subject to income tax by Section 201 or 204 of the Revenue Act of 1932 were expressly excepted from this tax. In the case of every other

corporation the test for the period from June 16 to June 30, 1933 and for subsequent years ending June 30 was whether or not it was carrying on or doing business.

A similar tax upon corporations had been in effect from 1916 to 1926, based upon the actual value of the capital stock, which had involved administrative difficulties arising from the question of value. In its report upon the bill the Senate Finance Committee said as to this:

> In order to avoid controversy as to the value of the capital stock the tax is imposed on the value declared by the corporation. A reasonable value is, however, assured by means of an excess profits tax imposed by section 215 and based on the relation of the net income of the corporation to such declared value. A value for the capital stock once having been declared, such value may not be subsequently changed except for bona fide charges in the capital structure.

This relation between the capital stock tax and the excess profits tax placed the taxpayer in the dilemma of deciding whether to declare a capital stock value which would involve high capital stock taxes and save possible excess profits taxes or to save capital stock taxes by declaring a low capital stock value and incur the risk of excess profits taxes. The solution of the question depended largely upon the time of the repeal of these taxes and, if repealed, whether or not they would be continued by reenactment. The opinion of the writer and his associates was that, although these taxes would be repealed under the provisions of the National Industrial Recovery Act, they would probably be reenacted, but, in the event of reenactment, the taxpayer would not be held to the capital stock value declared under the National Industrial Recovery Act.

By virtue of the President's proclamation the capital stock tax imposed by the National Industrial Recovery Act would not apply in respect of any year beginning on or after July 1, 1934.

Section 701 of the Revenue Act of 1934 reimposes the capital stock tax at the rate of $1 for each $1,000 of the adjusted declared value of its capital stock for each year ending June 30, beginning with the year ending June 30, 1934. It further provides that for the first year ending June 30 the adjusted declared value shall be the value as declared by the corporation in its first return under such section (which declaration cannot be amended), as of the close of its last income tax taxable year ending at or prior to the close of the year for which the capital stock tax is imposed (or as the date of organization in the case of a corporation having no income tax taxable year ending at or prior to the close of the year for which the capital stock tax is imposed.

It is further provided that for any subsequent year ending June 30 the adjusted declared value in the case of a domestic corporation shall be the original declared value *plus* (1) the cash and fair market value of property paid in for stock or shares, (2) paid-in surplus and contributions to capital, (3) its net income, (4) the excess of its income wholly exempt from income taxes over the amount disallowed as a deduction for income tax purposes, as an expense relating to a class of income other than interest, wholly exempt from income tax, and (5) the amount of the dividend deduction allowable for income tax purposes, and *minus* (A) the value of property distributed in liqui-

dation to shareholders, (B) distributions of earnings or profits, and (C) the excess of the deductions allowable for income tax purposes over its gross income. Such adjustments of the original declared value are to be made for each income tax taxable year included in the period from the date as of which the original declared value was declared to the close of its last income tax taxable year ending at or prior to the close of the year for which the capital stock tax is imposed. For a foreign corporation doing business in the United States the adjusted declared value for a year ending subsequent to June 30, 1934 is to be the original declared value adjusted in accordance with regulations prescribed by the Commissioner to reflect increases or decreases in the capital employed in the transaction of its business in the United States.

It will accordingly be seen that, regardless of any value for its capital stock originally declared by a corporation in its capital stock tax return filed for the year ended June 30, 1933, such corporation may in its capital stock tax return for the year ending June 30, 1934, under the Revenue Act of 1934, declare another original value for its capital stock (as of the end of the period for which its last income tax return was made), which original value will be adjusted for subsequent capital stock tax years.

Thus, in the case of a corporation which made an income tax return for the calendar year 1933, the original capital stock value to be declared for the capital stock tax year ending June 30, 1934, will be as of December 31, 1933. For the capital stock tax year ending June 30, 1935 the adjusted capital stock value will be the original value declared as of December 31, 1933, plus and minus the adjustments above described for the calendar year 1934.

Apparently the capital stock tax, as well as the excess profits tax upon corporations, will remain in the statutes for some time to come. Very careful consideration of the original capital stock value to be declared in the return for the year ending June 30, 1934 will be required, particularly in view of the application of this value as one of the bases of the excess profits tax. This return is due to be filed and the tax paid on or before July 31, 1934, unless the Commissioner extends such time, which he is empowered to do for not more than sixty days. Returns for subsequent periods are due together with payment within one month after the close of the year with respect to which such tax is imposed under an extension not to exceed sixty days is procured from the Commissioner.

The Commissioner has published Regulations 64 relating to the capital stock tax under Section 215 of the National Industrial Recovery Act. It is believed that these regulations are in substance applicable to the capital stock tax imposed by Section 701 of the Revenue Act of 1934, which supersedes Section 215 of the National Industrial Recovery Act.

**Excess Profits Tax**

Section 702 of the Revenue Act of 1934 substantially reenacts the excess profits tax upon corporations which was imposed by Section 216 of the National Industrial Recovery Act, and which had been repealed as of January 1, 1934 in respect of the calendar year 1934 or any income tax taxable year beginning after that date. Under

Section 701 the capital stock tax is imposed for the year ending June 30, 1934. The excess profits tax upon corporations under Section 702 is imposed upon its net income for each income tax taxable year ending after June 30, 1934 in an amount equivalent to 5 per cent. of such portion of its net income for such income tax taxable year as is in excess of 12½ per cent. of the adjusted declared value of its capital stock (or in the case of a foreign corporation the adjusted declared value of its capital employed in the transaction of its business in the United States) as of the close of its preceding income tax taxable year (or as of the date of organization if it had no preceding income tax taxable year), determined as provided for the capital stock tax. If the income tax taxable year upon which the excess profits tax is imposed is a period of less than 12 months the adjusted declared value is to be reduced to an amount which bears the same ratio thereto as the number of months in the period bears to 12 months.

For the purpose of the excess profits tax the net income is the same as the net income for income tax purposes for the year in respect of which the excess profits tax is imposed.

The application of the excess profits tax may be illustrated by the following example in the case of a corporation reporting for income tax purposes on the calendar year basis:

| | |
|---|---|
| Net income for calendar year 1934 | $100,000 |
| Less, 12½ per cent. of the value declared in the capital stock tax return of the corporation for the year ending June 30, 1934, of its capital stock as of December 31, 1933 (12½ per cent. of $500,000) ............ | 62,500 |
| Amount subject to excess profits tax under Section 702 of the Revenue Act of 1934.......... | $37,500 |
| Excess profits tax for the calendar year 1934, 5 per cent. of $37,500 | $1,875 |

It will readily be seen that, if the corporation in the above example had declared its capital stock value in the amount of $1,250,000, it would pay a capital stock tax for the year ending June 30, 1934 of $1,250 and no excess profits tax for the calendar year 1934, instead of a capital stock tax of $500 and $1,875 excess profits tax for the respective periods upon a declared capital stock value of $500,000, a difference against the taxpayer of $1,125.

Since the Revenue Act of 1934 is applicable only to income tax taxable years beginning after January 1, 1934 the income tax computation in the case of corporations having fiscal years beginning after that date will be the same as for calendar years. In the case of fiscal years ending on or before November 30, 1934, the net income upon which the computation is based will be computed under the provisions of the Revenue Act of 1932. Section 703 of the 1934 law provides that the excess profits tax imposed by Sections 216 of the National Industrial Recovery Act shall not apply to any taxpayer in respect of any taxable year ending after June 30, 1934.

The Commissioner in Treasury Decision 4390 published regulations relating to the excess profits tax under Section 216 of the National Industrial Recovery Act. It is believed that these regulations will be effective as to the excess profits tax under the Revenue Act of 1934, except as to the filing of consolidated excess profits tax returns. Since the Revenue Act of 1934

does not permit the filing of consolidated returns, except by railroad corporations, it is apparent that consolidated excess profits tax returns by other than railroad corporations for the calendar year 1934 and fiscal years beginning after January 1, 1934, will not be required or permitted. Consolidated excess profits tax returns for fiscal years ending prior to December 31, 1934 will apparently be permitted where income tax returns for the same period are made on that basis.

Excess profits tax returns are due at the same time as income tax returns, namely, within two months and fifteen days after the end of the period for which the returns are filed. The excess profits tax may be paid in the same manner as the income tax, either at the time of the filing the return or in quarterly instalments. A form for the excess profits tax return was embodied in the corporation form for the return of income taxes for 1933.

### Estate and Gift Taxes

The Revenue Act of 1934 (Section 405) has substantially increased the estate tax rates imposed by the Revenue Act of 1926 as amended by the Revenue Act of 1932. Corresponding increases have been made in the gift tax rates (Section 520). Comparative tables of the new and old estate tax and gift tax rates are printed elsewhere in this issue of the JOURNAL. These tables also show the amounts of the exemptions.

The increased estate tax rates became effective as to the estates of any persons dying after the enactment of the Revenue Act of 1934 on May 10, 1934 at 11.40 A. M. An estate tax return is required to be filed within one year after the date of death, if the value of the gross estate at the time of decedent's death exceeds $50,000.

The increased gift tax rates will not become effective until January 1, 1935. Gift tax returns are required to be filed on or before the fifteenth of March following the close of the calendar year during which gifts were made.

Estate taxes and gift taxes are no longer permitted to be deducted from the gross income reported for income tax purposes.

Section 401 of the Revenue Act of 1934 amended Section 302(d) of the Revenue Act of 1926, to include in the gross estate of a decedent the value of property transferred by him, but as to which he retained the right to alter, amend or revoke, to be exercised only after a precedent notice or even though the alteration, amendment or revocation can take effect only on the expiration of a stated period after the exercise of the power. The section also provides, in cases involving more than $5,000, a prima facie presumption that the relinquishment of any such power to alter, amend or revoke, if made within two years prior to the decedent's death, was in contemplation of death.

Section 404 of the new law makes the express provision that the value of real estate of a decedent located outside of the United States shall not be subjected to the estate tax.

### Dividend Tax

This tax, imposed under Section 213 of the National Industrial Recovery Act upon dividends declared after midnight of June 15, 1933, was repealed by virtue of the President's proclamation of December 5, 1933 as to any dividends declared after De-

cember 31, 1933. It was not reimposed by the Revenue Act of 1934.

It is of considerable interest, however, that in a recent ruling (I T 2766) the Commissioner of Internal Revenue took the position that the date of the declaration of a dividend within the meaning of the law, was the date of record as specified in the dividend resolution and not the date of the dividend resolution, where the resolution of the board of directors of a corporation provided for the payment of a dividend to stockholders of record as of a future date. It would seem that the word "declared" should be construed to have the meaning ordinarily attributed to it and refer to the date of the resolution. Obviously, any corporation which is called upon to pay a dividend tax because of this construction by the Commissioner should contest the ruling.

**Manufacturers' Sales Taxes**

*Tax on Certain Oils:* Section 602 of the 1934 law amends section 601 (c) of the Revenue Act of 1932 to provide a tax of three cents per pound upon the importation, after May 10, 1934, of whale oil (except sperm oil), fish oil (except cod liver, cod liver oil and halibut liver oil), marine animal oil and any combination or mixture containing a substantial quantity of any one or more of such oils.

*Processing Tax on Certain Oils:* Section 602½ of the 1934 law imposes a tax of three cents per pound upon the first domestic processing (to be paid by the processor) of coconut oil, sesame oil, palm oil, palm kernel oil, or sunflower oil or any combination or mixture containing a substantial quantity of any one or more of such oils. An additional tax of two cents per pound is also imposed, to be paid by the processor, upon the first domestic processing of coconut oil or any combination or mixture containing a substantial quantity of coconut oil with respect to which oil there has been no previous first domestic processing, except that such additional tax shall not apply when it is established that such coconut oil (a) is wholly the production of the Philippine Islands or any other possession of the United States, or (b) was produced wholly from materials of the growth or production of the Philippine Islands or any other possession of the United States, or (c) was brought into the United States on or before June 9, 1934, or (d) was purchased under a bona fide contract entered into prior to April 26, 1934, or produced from materials purchased under a bona fide contract entered into prior to April 26, 1934. It is further provided that all taxes collected under this section as to coconut oil wholly of Philippine production, or produced from materials wholly of Philippine growth or production, shall be paid into the Treasury of the Philippine Islands under certain restrictions.

At the time of this writing, it is understood to be the intention of the President to present to the Congress the desirability of immediately reconsiderng this tax on the ground that it violates the spirit of the Philippine Independence Act.

*Crude Petroleum Producers' Tax:* Effective on June 9, 1934, thirty days after the date of enactment of the Revenue Act of 1934 on May 10, 1934, a tax of 1/10 of one cent per barrel of 42 gallons is imposed by Section 604 of the 1934 law on the production of crude petroleum. This tax does not apply to the production from any well

which is not capable of producing more than 5 barrels per day. It is laid upon the producer but the purchaser is required to withhold the tax and make monthly returns. In cases where the producer himself removes the petroleum or disposes of it otherwise than by sale, the producer is required to return and pay the tax.

*Refining of Crude Petroleum:* In addition to the tax on the production of crude petroleum, Section 605 of the 1934 law imposes a tax of 1/10 of one cent per barrel of 42 gallons, to be paid monthly by the refiner or processor of crude petroleum and a like tax on gasoline produced or recovered in the United States from natural gas, to be paid by the person producing or recovering such gasoline.

*Lubricating Oils and Gasoline:* The 1934 law, by Section 603, amends Section 601 (c) (1) of the Revenue Act of 1932, relating to the tax of four cents a gallon on sales of lubricating oil and Section 617 of that act, relating to the tax of one cent a gallon on sales of gasoline, to require every person liable to the tax to register and file a bond, within thirty days after the enactment of the law on May 10, 1934, conditioned that he shall not engage in any attempt, by himself or by collusion with others, to defraud the United States of any tax under such sections; that he shall render truly and completely all returns, statements and inventories and shall pay all taxes due under such sections. Such bond is to be in such sum as the Collector of Internal Revenue may require, but is to be not less than $2,000. Severe penalties, not exceeding a fine of $5,000 or imprisonment for five years or both, are provided for violations.

The "producer" upon whom this tax is laid includes a refiner, compounder or blender, as well as a producer.

The term "gasoline" means gasoline, benzol, benzine, naphtha, and all liquids prepared, advertised, offered for sale or sold for use as, or used as, fuel for the propulsion of motor vehicles, motor boats, or airplanes, regardless of the chief use. There is specific exemption, however, of any product (not commonly or commercially known or sold as gasoline) sold for a nonmotor fuel use, such as kerosene, gas oil or fuel oil.

The avowed purpose of these changes is to insure collection of the tax due from "irresponsible and fly-by-night" manufacturers and producers and to eliminate the abuse of tax-free sales. There is also a provision for furnishing information to state officers from federal returns as to this tax in order to obtain more effective cooperation between federal and state officers in the enforcement of their respective gasoline and lubricating oil sales taxes.

*Candy:* Under Section 614 of the 1934 law, the tax of two per cent. on the sale of candy imposed by Section 613 of the Revenue Act of 1932, was terminated on May 10, 1934.

*Jewelry:* The 1934 law, by Section 609, exempts from the ten per cent. tax imposed by Section 605 of the 1932 law on the selling price of jewelry all articles sold by the manufacturer, producer or importer for less than $25. This provision became effective after enactment of the 1934 law on May 10. The former exemption was on articles sold for less than $3, except clock and watch parts which were exempt only to nine cents.

*Matches:* Section 611 of the 1934 law imposes upon sales by the manufacturer, producer or importer a tax

of five cents per 1,000 upon fancy wooden matches and wooden matches having a stained, dyed or colored stick or stem, packed in boxes or in bulk. As to all other matches, except paper matches in books, the tax remains at two cents per 1,000. The tax on paper matches in books remains at ½ cent per 1,000 matches. This change in the rate on colored matches was apparently made to offset advantages to importers under the tariff law.

*Soft Drinks Tax:* This tax under Section 615 of the Revenue Act of 1932, at rates varying from one and one-quarter to six cents per gallon, was repealed by Section 601 of the 1934 law effective after May 10, 1934.

*Furs:* The tax of ten per cent. upon furs imposed by Section 604 of the Revenue Act of 1932 upon sales by a manufacturer, producer or importer, has been modified by Section 608 of the 1934 law to exempt articles sold after May 10, 1934 for less than $75.

Upon all other articles subject to tax under the provisions of the Revenue Act of 1932 upon sales by the manufacturer, producer or importer the same rates have been extended to include June 30, 1935, except the tax on tires and inner tubes and on automobiles and automobile accessories, which is extended to include July 31, 1935.

**Miscellaneous Taxes**

*Sales of Produce for Future Delivery:* The stamp tax on sales of produce for future delivery imposed by Section 726 (c) of the 1932 law has been reduced by Section 612 of the Revenue Act of 1934 from five cents to three cents on each $100 value of such sales, effective May 10 1934.

*Bank Check Tax:* Section 606 of the 1934 law provides for the termination on January 1, 1935 of the tax of two cents on bank checks imposed by Section 751 of the Revenue Act of 1932.

*Boats:* The special tax (or license fee) on the use of boats is repealed as of July 1, 1934, by Section 613 of the 1934 law. This tax imposed by the Revenue Act of 1932, as amended by Section 212 of the National Industrial Recovery Act, would otherwise have terminated on July 1, 1935.

*Electrical Energy:* By Section 616 of the Revenue Act of 1932 a tax upon the domestic or commercial consumption of electrical energy was imposed upon the person paying for such consumption. This was amended by Section 6 (a) of the act of June 16, 1933 (Pub. No. 73—73rd Congress) to provide, effective September 1, 1933, that the tax should be paid at the same rate by the vendor. No further change has been made in respect to this tax except that the termination date has been extended to July 1, 1935.

The taxes imposed by the Revenue Act of 1932 on telegraph, telephone, radio and cable facilities, transfers and sales of bonds, real estate conveyances, oil pipe line transportation, which would otherwise have terminated on July 1, 1934, have been extended to July 1, 1935 by Section 212 of the National Industrial Recovery Act. The taxes on admissions, issues of bonds and of stocks, transfers and sales of stocks continue at the same rates to June 30, 1935, after which they are reduced.

*(Concluded on page 27)*

# The L. R. B. & M. Journal

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## The 1934 Revenue Act

The passage of the 1934 Revenue Act with its extremely high rates for various classes of taxes and with the reenactment of the capital stock and excess profits taxes will again cause taxpayers to give careful thought to the minimizing of their taxes. Obviously, the honest man, whether he be manufacturer, merchant, banker or investor, will not attempt to evade taxes which the law clearly lays upon him. On the other hand, it has time and time again been recognized by the courts, including the United States Supreme Court, that a taxpayer is justified in taking all proper means to minimize the taxes which he may be required to pay under the tax laws.

In the January issue of the JOURNAL we reproduced some recent comments by Colonel Montgomery on the distinction between tax avoidance and tax evasion. The opinion in a subsequent decision of the Board of Tax Appeals in *Chisholm v. Commissioner,* 29 B.T.A. No. 228, is interesting in that it touches on the same subject. It appears the taxpayer in that case took steps to minimize his tax liability in a transaction which had apparently yielded a large profit. The majority opinion of the Board, holding against the taxpayer, included the following:

> Some devices for reduction or avoidance

of taxes are, in the language of Mr. Justice Holmes in *Bullen v. Wisconsin*, 240 U. S. 625, on the "safe side," while other fall on the "wrong side of the line indicated by the policy if not by the mere letter of the law." In judging upon which side of the line a given act falls, a distinction may well be taken according to whether it is within the scope of the normal operating methods of the taxpayer with no more than a change in form so as to minimize future taxes, or whether the procedure adopted represents a radical departure from normal methods for the sole purpose of escaping taxes on transactions already carried so close to consummation that the shadow of taxation hovers over them. Such is the trend of the court decisions as we read them. * * * We think it may be taken as the announced policy of the courts, both in cases at law and in equity, that they will not countenance a scheme to escape taxes which involves an abrupt departure from normal procedure, devised and adopted with reference to a transaction upon which the imposition of tax is imminent, and solely for the purpose of avoiding liability. Such is the case here.

The dissenting opinion by Goodrich, a member of the Board, is extremely interesting, and is therefore given below:

I disagree with the majority opinion in laying as a test for successful tax avoidance the adherence by the taxpayer to the so-called normal procedure in the conduct of his affairs. In the first place, from the number of controversies involving avoidance attempts, it might well be argued that the normal procedure of most taxpayers in the conduct of their affairs includes any acts necessary to carry out a determination to pay taxes in such amounts as the law demands, and no more—a fact of which the majority opinion takes no cognizance. Next, I do not understand that a taxpayer must sit by idly twirling his thumbs until a tax liability alights on him. If he is warned of its approach, if he sees it coming, he may seek such shelter as the law offers in an effort to escape it or diminish its blow. Of course, by examination, it must be determined whether the shelter he reaches is really constructed of statutory material, and by close scrutiny of the facts it must be determined whether the taxpayer really got himself and his transactions within it. But he should not be counted out merely because the shelter lies off his beaten path and he scurries for it. The suggestion of the majority that every taxpayer must needs plod along the path laid by the past requirements of his business, meeting and paying any and all tax liabilities encountered, is highly Utopian—at least from the governmental view-point—and offers an ethical canon, interesting but quite beyond the necessities of decision in the instant controversy. Apparently it does not recognize that high taxes, like high water, may make an old path unusable, nor that on occasion a new path may be charted during the survey preliminary to entering upon a transaction in order to reckon with the tax demands certain to come. To say that the old path must be blindly followed, that bypaths or new paths may not be laid out by proper strides within legal bounds, goes too far.

The national debt is increasing at such a rapid rate and mounting to such an appalling height that it is evident we shall in all probability have very high federal taxes for a long time to come. It therefore follows that anyone who has an income, or realizes any gains, is going to have but relatively little of it left by the time the taxing authorities get through with him. Under these circumstances, the taxpayer cannot proceed with business or financial transactions without giving exceedingly careful thought to the tax liability which may be incurred. The prudent man will obviously do all he properly may to minimize his tax, and where, as in so many cases, form as well as substance are essential to the minimizing of the tax liability, he will be wise to be fully informed before proceeding with such transactions.

In all the effort of the present administration to weave various social aims into the pattern of legislation affecting business and finance, one point

which might well be considered in connection with the estate tax appears to have been entirely overlooked. This is all the more strange in that the laws of many states give intelligent consideration thereto, namely, that an estate should not be taxed merely as an entity but that regard should be had to the distribution that is made of the decedent's property.

If the estate tax is levied, as it seems to be, in part to secure revenue from an easy source, and in part to effect a redistribution of wealth, it would appear that this could be more fairly accomplished if the estate were not taxed as a single entity, but according to the diversity of the distribution that is to be made after the death of the decedent. For example, if an estate is to be distributed among five children, instead of going entirely to one child, there is a redistribution of wealth in the former case which does not occur in the latter. The burden of taxation is proportionately heavier in the case of each of the five children than in the case of the single child who inherits the entire estate. This has been so clearly recognized by so many states that it is difficult to understand why this point has not had consideration in the framing of the federal estate tax law. During the period when so large a part of the federal estate tax could be offset by taxes paid to the states, and when the rates were not as high as they now are, the point was perhaps not of such great importance. It seems obvious, however, that with the very high rates imposed by the 1934 act and the elimination in effect of a material part of the credit formerly allowed, this point ought to have serious consideration.

## New Edition of Federal Tax Handbook

Colonel Montgomery has work actively progressing on the preparation of a new edition of his Federal Tax Handbook in which the 1934 Revenue Act will be carefully considered. The effect of numerous important decisions which have been handed down by the courts and the Board of Tax Appeals since the publication of the 1933-1934 edition will also be dealt with.

As heretofore, the book will not be confined to giving official decisions and rulings by the Treasury, but will also present Colonel Montgomery's own views on ambiguous or controversial points. Tax payers need to bear in mind that, as the courts have repeatedly stated, the decisions of the Treasury, although entitled to respect, are not conclusive interpretations of the law.

## Significant Changes in the Income Tax Law

(*Continued from page 9*)

the trust is not revocable during the taxable year.

Federal estate taxes, state inheritance, estate, legacy, or succession taxes, or gift taxes, are not allowed as deductions from income under the new law.

No withholding will be required in the case of tax-free covenant bonds issued on or after January 1, 1934.

The time for filing petitions with the Board of Tax Appeals is extended to 90 days.

The President is authorized to double the taxes of any citizen or corporation of a country which levies discriminating or extraterritorial taxes against our citizens or corporations.

# Rates of Tax under the Revenue Act of 1934

By H. E. Bischoff

(*New York Office*)

As a result of the emergency expenditures of unprecedented amount, except in war times, recently made by the Federal Government, the national debt has been built up to staggering figures. In order to service this debt and at the same time provide for the usual governmental expenses, Congress found it necessary to continue in the 1934 Revenue Act substantially all of the taxes imposed under Revenue Act of 1932. Furthermore, there were included in the 1934 act several new taxes and the rates of the major taxes, such as income tax, estate tax and gift tax were increased to a point never before equaled except during the period of the World War and shortly thereafter.

Under existing strained conditions a feeble attempt was made to spare the middle class. There can be no doubt, however, that in this emergency Congress has carried out with a vengeance its intention to "soak the rich."

### Income Tax on Individuals

*Exemptions:* In the case of citizens and residents, the personal exemptions under the 1934 act remain the same as under the 1932 act, namely:

| *Taxpayer* | *Exemption* |
|---|---|
| Single | $1,000 |
| Married or head of family | 2,500 |
| Dependents | 400 each |

Where the status of a taxpayer changes during the year, whether because of death or otherwise, the exemption is apportioned in accordance with the number of months before and after such change.

A departure from previous laws is the allowance of the personal exemptions as a credit against net income when computing the surtax.

*Normal Rates:* Unlike prior acts, the 1934 law imposes only one rate for normal tax, to wit, 4 per cent. The normal tax is levied upon the net income in excess of the credits for personal exemptions, certain classes of dividends, interest on obligations of the United States and obligations of instrumentalities of the United States, and earned income. The surtax, however, is computed on net income in excess of the credits for personal exemptions only.

*Earned Income Credit:* The 1934 act restores the earned income credit first introduced under the 1924 act but discontinued under the 1932 act. The method of computing the allowance differs, however, in certain respects from the earlier procedure.

For the purpose of computing the normal tax only, a credit is allowed of 10 per cent. of the earned net income, which in turn is limited to 10 per cent. of the net income. The entire net income up to $3,000 is presumed to be earned net income, and the maximum amount that may be considered as earned net income is $14,000.

The maximum saving as a result of the earned income credit is 4 per cent. of $1,400, or $56.

*Surtax Rates:* The new basis for computing surtax is termed surtax net

income. Since the personal exemption and credit for dependents are now allowed in computing both the surtax and the normal tax, it is not possible to set forth exactly the amount of surtax payable when the net income alone is known.

That fact should be borne in mind when using the following table, which in addition to including the surtax also includes, for information purposes, a column covering the combined normal and surtax due on net income shown in the second column:

*Capital Gains and Losses:* The special rate of tax ($12\frac{1}{2}$ per cent.), applicable under specified conditions under all prior laws since 1921 with reference to capital gains and losses, is not continued under the 1934 act. However, the law provides for a percentage factor which is to be applied in determining the amount of gains and losses from sale of capital assets which is to be recognized in computing taxable net income. This factor is described in another article of this issue.

*Sale of Mines and Oil and Gas*

*Taxes Imposed Under 1934 Revenue Act*

| *Brackets of Net Income Married or Head of Family No Dependents* | *Amount Subject to Surtax (Net Income in Excess of Personal Exemptions)* | *Per Cent.* | *Total Surtax* | *Combined Normal and Surtax** |
|---|---|---|---|---|
| First $6,500 | First $4,000 | None | None | $ 160 |
| $ 6,500 to $ 8,500 | $ 4,000 to $ 6,000 | 4 | $ 80 | 320 |
| 8,500 to 10,500 | 6,000 to 8,000 | 5 | 180 | 500 |
| 10,500 to 12,500 | 8,000 to 10,000 | 6 | 300 | 700 |
| 12,500 to 14,500 | 10,000 to 12,000 | 7 | 440 | 920 |
| 14,500 to 16,500 | 12,000 to 14,000 | 8 | 600 | 1,160 |
| 16,500 to 18,500 | 14,000 to 16,000 | 9 | 780 | 1,420 |
| 18,500 to 20,500 | 16,000 to 18,000 | 11 | 1,000 | 1,720 |
| 20,500 to 22,500 | 18,000 to 20,000 | 13 | 1,260 | 2,060 |
| 22,500 to 24,500 | 20,000 to 22,000 | 15 | 1,560 | 2,440 |
| 24,500 to 28,500 | 22,000 to 26,000 | 17 | 2,240 | 3,280 |
| 28,500 to 34,500 | 26,000 to 32,000 | 19 | 3,380 | 4,660 |
| 34,500 to 40,500 | 32,000 to 38,000 | 21 | 4,640 | 6,160 |
| 40,500 to 46,500 | 38,000 to 44,000 | 24 | 6,080 | 7,840 |
| 46,500 to 52,500 | 44,000 to 50,000 | 27 | 7,700 | 9,700 |
| 52,500 to 58,500 | 50,000 to 56,000 | 30 | 9,500 | 11,740 |
| 58,500 to 64,500 | 56.000 to 62,000 | 33 | 11,480 | 13,960 |
| 64,500 to 70,500 | 62,000 to 68,000 | 36 | 13,640 | 16,360 |
| 70,500 to 76,500 | 68,000 to 74,000 | 39 | 15,980 | 18,940 |
| 76,500 to 82,500 | 74,000 to 80,000 | 42 | 18,500 | 21,700 |
| 82,500 to 92,500 | 80,000 to 90,000 | 45 | 23,000 | 26,600 |
| 92,500 to 102,500 | 90,000 to 100,000 | 50 | 28,000 | 32,000 |
| 102,500 to 152,500 | 100,000 to 150,000 | 52 | 54,000 | 60,000 |
| 152,500 to 202,500 | 150,000 to 200,000 | 53 | 80,500 | 88,500 |
| 202,500 to 302,500 | 200,000 to 300,000 | 54 | 134,500 | 146,500 |
| 302,500 to 402,500 | 300,000 to 400,000 | 55 | 189,500 | 205,500 |
| 402,500 to 502,500 | 400,000 to 500,000 | 56 | 245,500 | 265,500 |
| 502,500 to 752,500 | 500,000 to 750,000 | 57 | 388,000 | 418,000 |
| 752,500 to 1,002,500 | 750,000 to 1,000,000 | 58 | 533,000 | 573,000 |
| Over $1,002,500 | Over $1,000,000 | 59 | | |

*Before applying credit for "Earned Income," or any credits for dividends and interest on Liberty Bonds etc., allowed under Section 25.

*Wells:* The former limitation on surtax in case of the sale of mines, oil and gas wells, where the principal value of the property was demonstrated by prospecting or exploration, has been eliminated by the 1934 act.

*Nonresident Aliens:* In the case of nonresident alien individuals, regardless of marital status, the personal exemption allowed for normal and surtax purposes is limited to $1,000. The credit of $400 for dependents is allowed only to a resident of a contiguous country, namely, Canada or Mexico.

*Citizens and Corporations of Certain Foreign Countries:* A new provision incorporated in the 1934 act authorizes the President, whenever he finds that under the laws of any foreign country citizens or corporations of the United States are being subjected to discriminatory or extraterritorial taxes, so to proclaim, and thereafter the regular taxes shall be doubled in the case of each citizen and corporation of such foreign country subject to United States income tax. In no case shall such increase impose a tax to an amount in excess of 80 per cent. of the net income of the taxpayer. Whenever such laws of the foreign country are modified so that the discriminatory taxes are removed, upon proclamation by the President the imposition of the double rates will not apply with respect to any taxable year beginning after such proclamation is made.

*Estates and Trusts:* The same rates of taxes imposed on individuals apply also to the net income of estates and trusts. For the purpose of both the normal and surtax the personal exemption allowed is the same as for a single person, i.e., $1,000.

**Income Tax on Corporations**

*The tax rate* on all corporations which file separate returns, including insurance companies, is 13¾ per cent., the same rate as imposed under the prior law.

*Consolidated Returns:* The new revenue act includes a specific inhibition against the filing of consolidated corporate returns, except in the case of railroad corporations which are permitted to file consolidated returns under certain restrictions, and in which case the tax on the consolidated net income is increased to 15¾ per cent.

*Exemption:* As under the 1932 act, no specific credit is allowed in computing the corporation income tax.

*Credit for Interest on Obligations of United States or Its Instrumentalities:* For the purpose of computing the corporation tax, there is allowed as a credit against net income the amount received as interest on obligations of the United States or of instrumentalities of the United States.

*Retroactivity:* Section 1 of the 1934 act specifically states that the provisions of Title I dealing with the income tax shall apply only to taxable years beginning after December 31, 1933. This is an innovation, in that under prior laws separate tax calculations had to be made under two laws in the case of a return for a fiscal year ending in the first calendar year in which a new tax law is in effect.

Accordingly, the income tax rates under the 1934 law apply to taxable years beginning January 1, 1934 and subsequent thereto. In the case of a fiscal year ending at, or prior to, November 30, 1934, the rates under the 1932 act will apply with no adjustment for rates under the 1934 act.

**Estate Tax**

The 1932 act increased the rates of estate tax imposed under the 1926 act. The 1932 rates began at 1 per cent. on net estates (after deduction of a $50,000 exemption) not exceeding $10,000 and ran up to 45 per cent. on that portion of net estates in excess of $10,000,000.

The 1934 act further increases these additional estate tax rates in the case of net estates of more than $70,000, the new rate on that portion of net estates in excess of $10,000,000 being 60 per cent.

The 1934 rates apply only to estates of decedents dying after the enactment of the 1934 act (May 10, 1934), whereas the 1932 rates apply to estates of decedents dying after the enactment of the 1932 act (June 6, 1932) and before the enactment of the 1934 act.

The exemption allowed from the value of the net estate is $100,000 for the purpose of the computation under the 1926 law, whereas the exemption allowed for the purpose of the computation under the 1932 and 1934 laws is $50,000.

The following table shows the rates applicable under the 1926, 1932 and 1934 revenue acts. The amount of tax shown in each case is based on the maximum value of the net estate in each bracket.

**Estate Tax Rates**

Exemption 1926 law............. $100,000
Do 1932 and 1934 laws..... 50,000

| *Value of Net Estate (after deducting exemption)* | *1926 Law* Rate of Tax | *1926 Law* Amount of Tax | *1932 Law* Rate of Tax | *1932 Law* Amount of Tax | *1934 Law* Rate of Tax | *1934 Law* Amount of Tax |
|---|---|---|---|---|---|---|
| $ 0 to $ 10,000 | 1 Pct. | $ 100 | 1 Pct. | $ 100 | 1 Pct. | $ 100 |
| 10,000 to 20,000 | 1 | 200 | 2 | 300 | 2 | 300 |
| 20,000 to 30,000 | 1 | 300 | 3 | 600 | 3 | 600 |
| 30,000 to 40,000 | 1 | 400 | 4 | 1,000 | 4 | 1,000 |
| 40,000 to 50,000 | 1 | 500 | 5 | 1,500 | 5 | 1,500 |
| 50,000 to 70,000 | 2 | 1,500 | 7 | 5,000 | 7 | 2,900 |
| 70,000 to 100,000 | | | | | 9 | 5,600 |
| 100,000 to 200,000 | 3 | 4,500 | 9 | 14,000 | 12 | 17,600 |
| 200,000 to 400,000 | 4 | 12,500 | 11 | 36,000 | 16 | 49,600 |
| 400,000 to 600,000 | 5 | 22,500 | 13 | 62,000 | 19 | 87,600 |
| 600,000 to 800,000 | 6 | 34,500 | 15 | 92,000 | 22 | 131,600 |
| 800,000 to 1,000,000 | 7 | 48,500 | 17 | 126,000 | 25 | 181,600 |
| 1,000,000 to 1,500,000 | 8 | 88,500 | 19 | 221,000 | 28 | 321,600 |
| 1,500,000 to 2,000,000 | 9 | 133,500 | 21 | 326,000 | 31 | 476,600 |
| 2,000,000 to 2,500,000 | 10 | 183,500 | 23 | 441,000 | 34 | 646,600 |
| 2,500,000 to 3,000,000 | 11 | 238,500 | 25 | 566,000 | 37 | 831,600 |
| 3,000,000 to 3,500,000 | 12 | 298,500 | 27 | 701,000 | 40 | 1,031,600 |
| 3,500,000 to 4,000,000 | 13 | 363,500 | 29 | 846,000 | 43 | 1,246,600 |
| 4,000,000 to 4,500,000 | 14 | 433,500 | 31 | 1,001,000 | 46 | 1,476,600 |
| 4,500,000 to 5,000,000 | 14 | 503,500 | 33 | 1,166,000 | 48 | 1,716,600 |
| 5,000,000 to 6,000,000 | 15 | 653,500 | 35 | 1,516,000 | 50 | 2,216,600 |
| 6,000,000 to 7,000,000 | 16 | 813,500 | 37 | 1,886,000 | 52 | 2,736,600 |
| 7,000,000 to 8,000,000 | 17 | 983,500 | 39 | 2,276,000 | 54 | 3,276,600 |
| 8,000,000 to 9,000,000 | 18 | 1,163,500 | 41 | 2,686,000 | 56 | 3,836,600 |
| 9,000,000 to 10,000,000 | 19 | 1,353,500 | 43 | 3,116,000 | 58 | 4,416,600 |
| Over 10,000,000 | 20 | | 45 | | 60 | |

As heretofore two separate computations are required, (1) at the tax rates under the 1926 act, and with an exemption of $100,000 for the purpose of computing the 80 per cent. credit for state inheritance tax, and (2) at the rates under the 1934 act, and with an exemption of $50,000, less the tax computed at the 1926 rates. The net tax under the 1926 law (the first computation) is added to the net additional tax under the 1934 law (the second computation) to arrive at the total federal estate tax.

*Example:* Assume "A" died May 12, 1934, leaving a net estate of $300,000 before exemptions, and that he is entitled to the maximum credit for state inheritance tax.

*Tax Computed Under 1926 Act*

| | | |
|---|---|---|
| Net estate | $300,000 | |
| Less, Exemption | 100,000 | |
| Net estate after exemption | $200,000 | |
| Tax on $200,000 at 1926 rates | $4,500 | |
| Less, Credit for state inheritance tax, 80 per cent. of $4,500 | 3,600 | |
| Net tax under 1926 act | | $900 |

*Tax Computed Under 1934 Act*

| | | |
|---|---|---|
| Net estate | $300,000 | |
| Less, Exemption | 50,000 | |
| Net estate after exemption | $250,000 | |
| Tax on $250,000 at 1934 rates | $25,600 | |
| Less, Tax at 1926 rates | 4,500 | |
| Additional tax at 1934 rates | | 21,100 |
| Total estate tax | | $22,000 |

**Gift Tax**

The 1934 act revises the gift tax rates prescribed by the 1932 act so that they continue to be approximately three-fourths of the federal estate tax as under the present act.

In computing the gift tax the law provides that the first $5,000 (other than of future interest in property) given to any person may be excluded from taxable gifts in each year.

A specific exemption of $50,000 is also granted but that exemption applies to the cumulative gifts made from the passage of the Revenue Act of 1932 (June 6, 1932), and once the aggregate gifts exceed the exemption, the excess is subject to tax.

The tax is cumulative and advances to the higher brackets as the total value of all gifts increases from year to year.

*Rates:* The new rates under the 1934 act are applicable to the calendar year 1935 and later years only, and not to the calendar year 1934.

In the following table the rates under the 1932 law, as well as the rates under the amendment included in the 1934 law (applicable to calendar year 1935 and later years), are shown. The amounts of tax are computed on the maximum values in the respective brackets.

In computing the tax for 1935, and subsequently on the basis of cumulating the gifts from year to year, the new rates are to be applied to the gifts prior to 1935. However, the new rates are also to be used in computing the credit allowed for tax applicable to the total gifts taxed prior to 1935. The result, therefore, is that only the gifts after 1934 are taxed at the higher rates prescribed by the 1934 act.

## Gift Tax Rates

| Net Gifts (in Excess of $50,000 Exemption) | | Under 1932 Law Per Cent. | Under 1932 Law Total Tax | Under 1934 Law* Per Cent. | Under 1934 Law* Total Tax |
|---|---|---|---|---|---|
| $ 0 to | $ 10,000 | ¾ | $ 75 | ¾ | $ 75 |
| 10,000 to | 20,000 | 1½ | 225 | 1½ | 225 |
| 20,000 to | 30,000 | 2¼ | 450 | 2¼ | 450 |
| 30,000 to | 40,000 | 3 | 750 | 3 | 750 |
| 40,000 to | 50,000 | 3¾ | 1,125 | 3¾ | 1,125 |
| 50,000 to | 70,000 | 5 | 3,625 | 5¼ | 2,175 |
| 70,000 to | 100,000 | | | 6¾ | 4,200 |
| 100,000 to | 200,000 | 6½ | 10,125 | 9 | 13,200 |
| 200,000 to | 400,000 | 8 | 26,125 | 12 | 37,200 |
| 400,000 to | 600,000 | 9½ | 45,125 | 14¼ | 65,700 |
| 600,000 to | 800,000 | 11 | 67,125 | 16½ | 98,700 |
| 800,000 to | 1,000,000 | 12½ | 92,125 | 18¾ | 136,200 |
| 1,000,000 to | 1,500,000 | 14 | 162,125 | 21 | 241,200 |
| 1,500,000 to | 2,000,000 | 15½ | 239,625 | 23¼ | 357,450 |
| 2,000,000 to | 2,500,000 | 17 | 324,625 | 25½ | 484,950 |
| 2,500,000 to | 3,000,000 | 18½ | 417,125 | 27¾ | 623,700 |
| 3,000,000 to | 3,500,000 | 20 | 517,125 | 30 | 773,700 |
| 3.500,000 to | 4,000,000 | 21½ | 624,625 | 32¼ | 934,950 |
| 4,000,000 to | 4,500,000 | 23 | 739,625 | 34½ | 1,107,450 |
| 4,500,000 to | 5,000,000 | 24½ | 862,125 | 36 | 1,287,450 |
| 5,000,000 to | 6,000,000 | 26 | 1,122,125 | 37½ | 1,662,450 |
| 6,000,000 to | 7,000,000 | 27½ | 1,397,125 | 39 | 2,052,450 |
| 7,000,000 to | 8,000,000 | 29 | 1,687,125 | 40½ | 2,457,450 |
| 8,000,000 to | 9,000,000 | 30½ | 1,992,125 | 42 | 2,877,450 |
| 9,000,000 to | 10,000,000 | 32 | 2,312,125 | 43½ | 3,312,450 |
| 10,000,000 up | | 33½ | | 45 | |

* Applicable to year 1935 and thereafter.

*Example:* Assuming that from June 7, 1932 to December 31, 1933, inclusive, "B" had made gifts aggregating $150,000, or $100,000 in excess of the $50,000 specific exemption, and that during 1934 he made further net gifts of $100,000, the tax on the 1934 gifts would be computed as follows:

| | |
|---|---|
| Net gifts, 1932-33 ($150,000 less $50,000) | $100,000 |
| Net gifts, 1934 | 100,000 |
| Total accumulated gifts | $200,000 |
| Tax on accumulated gifts of $200,000 at rates under 1932 law | $10,125 |
| Less, Tax on accumulated gifts of $100,000 in 1932-33 at rates under 1932 law | 3,625 |
| Tax due on 1934 gifts | $6,500 |

If in the above illustration the accumulated gifts to December 31, 1934 amounted to $150,000, or $100,000 over the specific exemption, and an additional $100,000 of gifts were made in 1935, the 1934 act rates would then apply as follows:

| | |
|---|---|
| Net gifts to December 31, 1934 ($150,000 less $50,000) | $100,000 |
| Net gifts, 1935 | 100,000 |
| Total accumulated gifts | $200,000 |
| Tax on accumulated gifts of $200,000 at rates under 1934 law | $13,200 |
| Less, Tax on accumulated gifts of $100,000 to December 31, 1934, at rates under 1934 law | 4,200 |
| Tax due on 1935 gifts | $9,000 |

(*Concluded on page 27*)

# Notes

Colonel Montgomery delivered an address on Cost Protection and Pricing before the Round Table Session on Progress and Problems in the Manufacturing Industries at the annual meeting of the Chamber of Commerce of the United States in Washington on May 2.

On March 6 Mr. Staub gave a radio talk over Station WJZ of the National Broadcasting Company on The Need for the Publication of Accurate Information on the Affairs of Municipalities; on April 4 he delivered an address to the Pace Alumni Association on Security Issues and Stock Exchanges; on April 13 and 14 he addressed meetings of chapters of the New York Society of Certified Public Accountants in Buffalo, Rochester and Syracuse; on April 17 he spoke to the New York Conference of the Association of Bank Auditors and Comptrollers on Cooperation Between Bankers and Auditors; and on April 20 he addressed the Eastern Regional Conference of the National Association of Bank Auditors and Comptrollers meeting in Philadelphia on the General Accounting Policies of Banks. At the annual meeting of the New York Society of Certified Public Accountants on May 14, Mr. Staub was reelected president for the ensuing year.

## Rates of Tax under the Revenue Act of 1934

(*Continued from page 26*)

The various excise and miscellaneous taxes imposed by the 1932 act were, for the most part, continued under the 1934 act.

New taxes of this class which were imposed by the 1934 act, changes in rates of existing excise taxes continued, and excise taxes which were eliminated by that act, are dealt with in another article in this issue.

## Excise Taxes under the Revenue Act of 1934

(*Continued from page 17*)

*Postal Rates:* The increase in postal rates imposed by Section 1001 (a) of the 1932 law, as amended, now expires on July 1, 1935 instead of July 1, 1934, by virtue of Section 515 of the Revenue Act of 1934. The President is authorized, however, to amend these rates during the period ending June 30, 1935 (Sec. 2 of Pub. No. 73—73rd Congress).

# A Tax Parade*

**Sydney Smith's Warning to Our Young Republic in 1820**

We can inform Jonathan [America] what are the inevitable consequences of being too fond of glory:—Taxes upon every article which enters into the mouth, or covers the back, or is placed under the foot—taxes upon everything which is pleasant to see, hear, feel, smell or taste—taxes upon warmth, light and locomotion—taxes on everything on earth, and the waters under the earth—on everything that comes from abroad, or is grown at home—taxes on the raw material—taxes on every fresh value that is added to it by the industry of man—taxes on the sauce which pampers man's appetite, and the drug that restores him to health—on the ermine which decorates the judge, and the rope which hangs the criminal—on the poor man's salt, and the rich man's spice—on the brass nails of the coffin, and the ribands of the bride—at bed or board, couchant or levant, we must pay.

The schoolboy whips his taxed top—the beardless youth manages his taxed horse, with a taxed bridle, on a taxed road:—and the dying Englishman, pouring his medicine, which has paid 7 per cent, into a spoon that has paid 15 per cent—flings himself back upon his chintz-bed, which has paid 22 per cent,—makes his will on an eight-pound stamp, and expires in the arms of an apothecary who has paid a license of an hundred pounds for the privilege of putting him to death. His whole property is immediately taxed from 2 to 10 per cent. Besides the probate, large fees are demanded for burying him in the chancel; his virtues are handed down to posterity on taxed marble; and he is gathered to his fathers—to be taxed no more.

In addition to all this, the habit of dealing with large sums will make the Government avaricious and profuse; and the system itself will infallibly generate the base vermin of spies and informers, and a still more pestilential race of political tools and retainers of the meanest and most odious description;—while the prodigious patronage which the collecting of this splendid revenue will throw into the hands of the Government, will invest it with so vast an influence, and hold out such means and temptations to corruption as all the virtue and public spirit, even of republicans, will be unable to resist.

*From a review by Sydney Smith, printed in the *Edinburgh Review*, January, 1820, of "Statistical Annals of the United States of America," by Adam Seybert.

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